EXHIBIT 23

THE CITY OF SAN DIEGO, CALIFORNIA
MINUTES FOR REGULAR COUNCIL MEETING
OF
MONDAY, OCTOBER 21, 2002
AT 2:00 P.M.
IN THE COUNCIL CHAMBERS - 12TH FLOOR

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CHRONOLOGY OF THE MEETING:

The meeting was called to order by Mayor Murphy at 2:07 p.m.

Mayor Murphy adjourned the meeting at 4:22 p.m. to Closed Session on Tuesday, October 22, 2002 in the 12th floor conference room to discuss pending and potential litigation and Meet and Confer matters.

ATTENDANCE DURING THE MEETING:

(M) Mayor Murphy-present

(1) Council Member Peters-present

(2) Council Member Wear-present

(3) Council Member Atkins-present

(4) Council Member Stevens-present

(5) Council Member Maienschein-present

(6) Council Member Frye-present

(7) Council Member Madaffer-present

(8) Council Member Inzunza-present

Clerk-Abdelnour (er)

FILE LOCATION: MINUTES

Exempting an Assistant to the Director Position from the Classified Service in the Governmental Relations Department.

FILE LOCATION: MEET

COUNCIL ACTION: (Tape location: B214-435.)

CONSENT MOTION BY PETERS TO DISPENSE WITH THE READING AND ADOPT THE ORDINANCE. Second by Wear. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

* ITEM-53: Approval of Ordinance amending the San Diego Municipal Code related to FY 2003 Negotiated Retirement Benefit Enhancements.

CITY MANAGER'S RECOMMENDATION:

Introduce the following ordinance:

(O-2003-67) INTRODUCED, TO BE ADOPTED ON MONDAY, NOVEMBER 11, 2002

Introduction of an Ordinance amending Chapter II, Article 4 of the San Diego Municipal Code by amending Division 2 by amending Section 24.0201; by amending Division 3 by amending Section 24.0301; by amending Division 4 by amending Section 24.0402; by amending Division 5 by amending Section 24.0501; by amending Division 8 by amending Section 24.0801, and by Renumbering Section 24.0803 as Section 24.0802; by amending Division 12 by amending Sections 24.1201, 24.1202, 24.1203 and 24.1204; by amending Division 15 by amending Section 24.1507; all relating to the San Diego City Employees' Retirement System.

CITY MANAGER SUPPORTING INFORMATION:

Pursuant to the recently negotiated Memoranda of Understanding and associated agreements with the Fire Fighters Local 145, Municipal Employees Association (MEA), AFSCME Local 127 and the Police Officers Association (POA) the City agreed to implement a number of revisions to Retirement Benefits as defined in the San Diego Municipal Code. Those benefit enhancements and associated San Diego Municipal Code amendments are summarized below:

Presidential Leave - Amends Sections 24.0201 and 24.0301 to provide that a member serving as the duly elected president of a recognized employee labor organization may continue participating in the Retirement System consistent with the governing Memorandum of Understanding (MOU) between the City and his/her employee organization.

Retirement Benefit Factor increase - Amends Section 24.0402 to reflect the new retirement factor (2.5% at 55) available to General Members, as well as the 90% cap on benefits and exceptions to the cap that accompany the new retirement factors.

Stress Disability Benefit Extension - Amends Section 24.0501 to extend the benefit for Members who suffer mental disabilities due to a violent attack in the workplace, from July 1, 2002 to July 1, 2005.

CERS Contribution Agreement - Amends Section 24.0801 to state that the City's contributions to the Retirement System will be based on the terms of a Memorandum of Understanding between the City and the San Diego City Employees Retirement System (SDCERS).

Retiree Health Benefits - Amends Section 24.1202 to reflect the agreed upon reimbursement levels for Health Eligible Retirees.

Employer Offsets - Amends Section 24.1507 to allow payment of the negotiated offsets to employee contributions from the Employee Contribution Reserve; also amends Section 24.1507 to describe more clearly the terms of the Employee Contribution Rate Reserve.

Once approved by City Council, these benefits will be submitted to members of the City Employees' Retirement System (CERS), and will be enacted upon an affirmative vote of the members. This election is tentatively slated for the last week of November, 2002.

FISCAL IMPACT:

Cost of $4.79M for 2.5% at 55 benefit enhancement ($2.26M General Fund; $2.53M Non-General Fund). Costs of $11.34M for Retiree Health Benefits (from CERS 401 (h) & 115 Health Trust Reserves); and $3.24M for Employee Offsets (from CERS Employee Contribution Rate Reserve) were approved by Council July 30, 2002.

Lexin/Kelly

FILE LOCATION: NONE

COUNCIL ACTION: (Tape location: B214-435.)

CONSENT MOTION BY PETERS TO INTRODUCE THE ORDINANCE. Second by Wear. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

ITEM-100: Agreement with Metcalf & Eddy to Provide Vulnerability Assessment Services.

CITY MANAGER'S RECOMMENDATION:

Adopt the following resolution:

(R-2003-522) ADOPTED AS RESOLUTION R-297199

Authorizing the City Manager to execute an agreement with Metcalf and Eddy, Inc. to provide professional consultant services for a Water Security Vulnerability Assessment;

Authorizing the City Auditor and Comptroller to transfer an amount of reimbursable funds, not to exceed $115,000 from the U.S. Environmental Protection Agency grant funding to Water Operating Fund 41500;

Authorizing the expenditure of an amount not to exceed $115,000 from Water Operating Fund 41500, provided that the City Auditor and Comptroller first furnishes one or more certificates demonstrating that the funds necessary for expenditure are, or will be, on deposit in the City Treasury.

CITY MANAGER SUPPORTING INFORMATION:

In order to improve the safety and security of the Nation's water supply, the United States Environmental Protection Agency has appropriated funds to reduce the vulnerability of water utilities to terrorist attacks and to enhance their ability to respond to emergency situations. The Environmental Protection Agency (EPA) has awarded the City of San Diego $115,000. On October 7, 2002, City Council authorized the City Manager to accept the EPA award to complete a vulnerability assessment by January 31, 2003.

EXHIBIT 24

THE CITY OF SAN DIEGO

November 18, 2002

Honorable Dick Murphy and Members of the City Council
City of San Diego
City Hall - 202 C Street
San Diego, CA 92101

Re: Items 50 & 51; re Retirement Benefits

Dear Mayor Murphy and Members of the City Council:

CITY ASKED TO ENTER INTO IMPRUDENT FINANCING PROGRAM WHICH FAILS TO CORRECT ACCOUNTING IRREGULARITIES AND THREATENS SAFETY OF CITY EMPLOYEES RETIREMENT AND BENEFIT SYSTEM IN CONFLICT WITH ACTUARY'S ADVICE

Action items 50 and 51 represent a potential insolvency formula for the City of San Diego in less than 9 years.

This deal has surfaced because, under the existing 1996 City Manager's Agreement, if the Retirement Plan's funding ratio (the amount funded vs. the funding requirement designated by the independent Actuary) falls below 82.3%. (which our Actuary has suggested will happen this year), the City is required to make a much larger contribution ($25 – 75 million this year and even larger in future years) to restore the plan's funding status. It appears that the City does not want to make these required payments. This new agreement before you today was reached to allow the City not to have to make the required payments and in return an additional employee benefit was granted. The new agreement "back loads" the entire accrued burden to the City Council of 2009.

Because the City could not compel the Retirement Board to accept this dangerous agreement, the City "conditioned" the Labor deal on Retirement Board approval of the City's diminished pension contribution agreement and balloon payment obligation agreement, and then had City representatives and Labor representatives vote it through the Retirement Board this past Friday (the motion passed with two dissenting votes, myself and that of Tom Rhodes). This conditioning of benefit enhancements on Retirement Board approval created conflicting concerns on the part of City and Labor representatives that sit as Trustees on the Retirement Board. The City Trustees faced concerns of job preservation and personal economic benefit, and the Labor Trustees faced the obviously enhanced pension benefits to their members. The City should not have put the City and Labor members of the Retirement Board in this awkward position. Tying a labor contract benefit to a separate fiduciary decision co-ops the Board's normal role as overseer of the "administration" of benefits. In a sense, it gives the appearance, if not the reality, that the City "bought" votes on the Retirement Board.

I commented at this past weeks Retirement Board meeting, that promising a city employee benefit conditioned upon a separate fiduciary's approval of an agreement to reduce the already deficient City contributions to its pension plan is ethically questionable at best, if not blatantly corrupt.

BACKGROUND

City Council Items 50 and 51on the Agenda for November 18, 2002 require your approval of Ordinances that amend the San Diego Municipal Code in relation to the FY 2003 Negotiated Retirement Benefit Enhancements. The affect of the proposed Ordinances would, among other things:

1. Lower the City's existing contribution rate (specifically if the plan falls below 82.3% funded) which has already been found by the independent Actuary to be currently inadequate to provide for the contracted retirement obligations for City employees,
2. Provide increased benefits without providing any current funding to fund those benefits,
3. Create a balloon obligation for the City to partially fund the accrued but unpaid obligations identified in 1 and 2 above, which will begin the year after the expiration of the term limits of the existing Council and Mayor,
4. Allow for an unspecified "transition period" to change the Retirement System's irregular and misleading "Projected Unit Credit (PUC) rate" accounting practices (these are our existing non-conforming accounting practices) to the more conventional and accurate "Entry Age Normal (EAN) rate" (the accounting methods used by the vast majority of other California public retirement systems, see attached list of Public Pensions Systems in California using EAN.)

These Ordinances came about as a result of the "meet-and-confer" process between the City and its Labor Unions. The Retirement Board, as a body, is not a party to those negotiations, although representatives of labor and City Management are involved. The Retirement Board was subsequently asked to approve this new reduced pension contribution agreement and balloon payment obligation agreement after the deal had been made by the City and the Unions. Because the City could not compel the Retirement Board to accept this dangerous agreement, the City "conditioned" the Labor deal on Retirement Board approval of the diminished pension contribution agreement and balloon payment obligation agreement, and then had City representatives and Labor representatives vote it through the Retirement Board this past Friday (the motion passed with two dissenting votes from Trustee Tom Rhodes and myself).

In addition, the proposed Ordinances provide an unspecified "transition period" to change over from what is known to be irregular and misleading accounting practices used by the City's Retirement System rather than require immediate accounting compliance with the more accurate and intelligible methods and procedures used everywhere else.

The proposed Ordinances and the decision to approve them are fiscally reckless and irresponsible. It does not ensure the financial integrity and the security of the Retirement System. These proposed ordinances, if approved, additionally weaken the already financially impaired retirement system because:

1. The Retirement System is currently under-funded as a result of the 1996 City Manager's proposal. According to the System's Fiduciary Council, from July 1, 1996 through June 30, 2002, the deficiency between what the City contributed and what would have been contributed under the amounts computed in accordance with the actuarial valuation, plus earnings on the difference totals about $100 million. According to the System's independent Actuary, as of the June 30, 2001 Annual Actuarial Valuation the unfunded actuarial accrued liability was $283,892,737. If these ordinances are approved, by 2009, the City will most likely be faced with the "sticker shock" of an unfunded pension liability in the multiple billions of dollars.
2. According to the Retirement System's independent Actuary, on an "EAN" measurement basis, ***the San Diego City Employees' Retirement System already has one of the lowest funding ratios in the State of California.*** (Measurement by the more generous "PUC" method showed that in 1996 the pension plan was 91% funded, by the end of this year it will most likely drop below 80%).
3. According to the Retirement System's independent Actuary, the San Diego City Employee's Retirement Systems' ***funding ratio is already the lowest it has been since the 1980's.***
4. City contributions have *not* increased over the scheduled amounts in the 1996 Manager's Proposal even though the City granted benefit increases under the Retirement System since the adoption of that Proposal, most notably, the benefits provided under the "Corbett" settlement.

5. The Retirement System has lost hundreds of millions dollars in it's investment portfolio.
6. The System's investment consultant forecasts the likelihood of lower and more volatile earnings in the future than in the past 10 years.
7. The substantial reduction in interest rates due to action by the Federal Reserve Bank has materially decreased the current interest received and potential future interest generated by the fixed income portion of the System's investment portfolio.
8. Many Retirement System liabilities are not even included in the System's existing irregular (PUC rate) accounting system for calculating the funding ratio. For example, there are hundreds of millions of dollars of obligations the System does not reflect on its books, such as the "Corbett" settlement obligation for retirees – worth about $76 million dollars, two Reserve Account obligations, the reserve for Supplemental COLA, the 13th Check obligation, or the Retiree Health Insurance and Post Retiree Heath Care obligation. Additionally, there is no consideration of the fact that employees are retiring at an earlier age, which has a major impact on future Retirement System obligations and has been strongly recommended be included by the Actuary for several years. All of the above liabilities have been noted by the System's independent Actuary as being significant economic reporting omissions and if considered would materially lower the current funding capacity.
9. After meeting it's other obligations, it is expected that the Retirement System will effectively have no "surplus earnings" at the year ending June 30, 2002, to fund new benefits or to make up funding shortfalls.

The Retirement System's independent Actuary has consistently opposed the items reflected in these two proposed ordinances in the most explicit of terms and has specifically written in a letter dated November 5, 2002 to the Retirement Board, ***"it would be best to hold the City to the existing Manager's proposal..."*** Additionally, the Actuary has recommended against the "transition period" for correcting the inadequate accounting practices, which have created an artificially healthier appearance of the System's financial condition. Specifically he writes, ***" we would prefer it if the Board did not provide a transition period to the City to reach the full PUC rate and then move to the full EAN rate."*** (See attached letter from Actuary). The Actuary may be replaced as a result of his honesty and professionalism.

One if the legal cases provided to us by our fiduciary counsel is enlightening. The most recent decision in California with respect to funding requirements states, *"The willingness and ability of the sponsor of a defined benefit pension plan to maintain this 'orderly schedule' (of contributions well in advance of benefit requirements) is the major factor in the assurance of benefit security for retirees..."* 52 Cal.App.4th 1139, quoting from the declaration of the PERS Actuary. Additionally, that decision said, in part, *"Underpinning both the normal cost calculation and the amortization of the unfunded accrued actuarial liability is an explicit assumption concerning timing of contributions.' The importance of timing stems from the fact that a large portion of a member's benefit is funded by the investment earnings, which are generated by the plan contributions. When monies are contributed later than expected, reduced earnings result – thus creating a shortfall."* at 1140 quoting from the PERS Actuary. Board of Administration v. Wilson, 52 Cal.App.4th (1997).

The Government Finance Officers Association has said that public officials should do the following: *"Assure that actuarially required contributions are collected by the pension plan on a timely basis. Reductions in or postponement of contributions violates one of the basic principles of level percent-of-payroll financing and constitutes a real threat to responsible funding." (GFOA STATEMENT OF RECOMMENDED PRACTICIES FOR PUBLIC PENSION PLANS, Recommendation 3 concerning funding.)*

CONCLUSION

I strongly recommend that you, as representatives of the public trust, do not vote to approve these Ordinances. However, if you are intent upon doing so, I would suggest that you send this issue to your

Ethics Commission before voting on it. I would also strongly recommend that you have outside Legal Council provide you with an opinion on this issue. In discussions with the Retirement Systems' Fiduciary Council it was suggested that approval actions may not be covered by governmental immunity and that there may be a personal exposure resulting from an affirmative vote on this matter.

Respectfully,

Diann Shipione

Diann Shipione
Trustee, San Diego City Employees' Retirement System

cc: Trustees of the San Diego City Employees' Retirement System
Rick Roeder, Actuary, Gabriel, Roeder, Smith & Company
Bob Blum, Esq. Fiduciary Counsel
Mr. Charles Walker

EXHIBIT 25

THE CITY OF SAN DIEGO, CALIFORNIA
MINUTES FOR REGULAR COUNCIL MEETING
OF
MONDAY, NOVEMBER 18, 2002
AT 2:00 P.M.
IN THE COUNCIL CHAMBERS - 12TH FLOOR

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CHRONOLOGY OF THE MEETING:

The meeting was called to order by Mayor Murphy at 2:04 p.m. The meeting was recessed by Mayor Murphy at 3:04 p.m. for the purpose of a break. Mayor Murphy reconvened the meeting at 3:11 p.m. with all Council Members present. The meeting was recessed by Mayor Murphy at 4:46 p.m. for the purpose of a break. Mayor Murphy reconvened the meeting at 4:53 p.m. with all Council Members present. Mayor Murphy adjourned the meeting at 6:06 p.m. into Closed Session at 9:00 a.m. on Tuesday, November 19, 2002, in the twelfth floor conference room to discuss existing and anticipated litigation.

ATTENDANCE DURING THE MEETING:

(M) Mayor Murphy-present

(1) Council Member Peters-not present

(2) Council Member Wear-present

(3) Council Member Atkins-present

(4) Council Member Stevens-present

(5) Council Member Maienschein-present

(6) Council Member Frye-present

(7) Council Member Madaffer-present

(8) Council Member Inzunza-present

Clerk-Abdelnour (pr)

FILE LOCATION: MINUTES

ITEM-1: ROLL CALL

Clerk Abdelnour called the roll:

(M) Mayor Murphy-present
(1) Council Member Peters-present
(2) Council Member Wear-present
(3) Council Member Atkins-present
(4) Council Member Stevens-present
(5) Council Member Maienschein-present
(6) Council Member Frye-present
(7) Council Member Madaffer-present
(8) Council Member Inzunza-present

ITEM-10: INVOCATION

Invocation was given by Reverend Louis G. Wargo of the Kensington Community Church.

FILE LOCATION: MINUTES

ITEM-20: PLEDGE OF ALLEGIANCE

The Pledge of Allegiance was led Assistant City Attorney Leslie Devaney.

FILE LOCATION: MINUTES

ITEM-30: Mr. Abdur-Rahim Hameed Day.

DEPUTY MAYOR STEVENS' RECOMMENDATION:

Adopt the following resolution:

(R-2003-582) ADOPTED AS RESOLUTION R-297300

Commending Mr. Abdur-Rahim Hameed for his contributions and dedication to the City of San Diego;

FILE LOCATION: AGENDA

COUNCIL ACTION: (Time duration: 2:15 p.m. - 2:18 p.m.)

MOTION BY MAIENSCHEIN TO ADOPT. Second by Stevens. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

COUNCIL COMMENT:

ITEM-CC-1:

Deputy Mayor Stevens wished to comment that the Evans Family Inn at Torrey Pines was being honored in San Francisco that evening as a five star Hotel that is receiving five diamond points.

FILE LOCATION: MINUTES

COUNCIL ACTION: (Time duration: 6:02 p.m. - 6:03 p.m.)

ITEM-50: Approval of Ordinance amending the San Diego Municipal Code related to FY 2003 Negotiated Retirement Benefit Enhancements.

CITY COUNCIL'S RECOMMENDATION:

Adopt the ordinance which was introduced on 10/21/2002 (Council voted 9-0):

(O-2003-67 Cor. Copy) ADOPTED AS ORDINANCE O-19121 (New Series)

Amending Chapter II, Article 4 of the San Diego Municipal Code by amending Division 2 by amending Section 24.0201; by amending Division 3 by amending Section 24.0301; by amending Division 4 by amending Section 24.0402; by amending Division 5 by amending Section 24.0501; by amending Division 8 by amending Section 24.0801, and by Renumbering Section 24.0803 as Section 24.0802; by amending Division 12 by amending Sections 24.1201, 24.1202,

24.1203 and 24.1204; by amending Division 15 by amending Section 24.1507; all relating to the San Diego City Employees' Retirement System.

FILE LOCATION: MEET

COUNCIL ACTION: (Time duration: 2:31 p.m. - 2:53 p.m.)

MOTION BY INZUNZA TO DISPENSE WITH THE READING AND ADOPT THE ORDINANCE. Second by Madaffer. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-nay, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

ITEM-51: Approval of Ordinance amending San Diego Municipal Code related to FY 2003 Negotiated Retirement Benefits.

CITY MANAGER'S RECOMMENDATION:

Introduce the following ordinance:

(O-2003-74) INTRODUCED, TO BE ADOPTED ON TUESDAY, DECEMBER 3, 2002

Introduction of an Ordinance amending the San Diego Municipal Code by amending Division 13 by amending Sections 24.1310 and 24.1312; by amending Division 14 by amending Sections 24.1402, 24.1403, and 24.1404; all relating to the San Diego City Employees' Retirement System.

CITY MANAGER SUPPORTING INFORMATION:

As a result of the recent contract negotiations with the Police Officers' Association, Fire Fighters Local 145, Municipal Employees Association, and AFSCME, Local 127, the City Management Team agreed to implement a number of revisions to the Retirement System. Ordinance O-2003-67 was introduced at the October 21, 2002 meeting of the City Council which amends the San Diego Municipal Code to reflect the majority of the revisions to the Retirement System negotiated during the FY 2003 Meet and Confer process.

However, Ordinance O-2003-67 did not include the revisions to the Retirement System (SDCERS) giving Members represented by Fire Fighters Local 145 the ability to convert Annual

Leave accrued after July 1, 2002 to service credit in SDCERS or extend their participation in the System's Deferred Retirement Option Plan ("DROP").

Ordinance O-2003-67 did not include a revision to the Retirement System removing the current prohibition against counting a purchase of service credit made pursuant to the General Provision for Five Year Purchase of Creditable Service set forth in San Diego Municipal Code Section 24.1312 towards the ten year vesting requirement set forth in Section 141 of the San Diego City Charter. This action will remove the prohibition and allow the purchase of creditable service to apply towards the ten year vesting requirement.

Effective July 1, 2002, represented Members in the Local 145 bargaining unit who have not yet entered DROP will be allowed to convert the cash equivalent of their Annual Leave accrued after July 1, 2002 to service credit in SDCERS or extend their DROP participation period.

Represented Members in the Local 145 Bargaining Unit will no longer be able to exercise any cash out feature of Annual Leave accrued after July 1, 2002. Represented Members in the Local 145 bargaining unit who have balances of Annual Leave accrued after July 1, 2002, will be allowed to extend their DROP participation period beyond the five year maximum by that amount of post July 1, 2002 Annual Leave still available and not converted to service credit prior to entering DROP. A vote of the Retirement System Members to approve these changes in this ordinance affecting Member benefits will take place from November 2002 through December 2002.

FISCAL IMPACT:

The conversion of Annual Leave to service credit in the Retirement System or extension of the Member's DROP participation period may result in an increase to the Retirement System's unfunded liability and a corresponding increase to the City's contribution rate over and above the scheduled rates in the Manager's Proposal.

The amount of any increase to the System's unfunded liability and City's contribution rate will depend upon the usage of Annual Leave accrued after July 1, 2002 that is converted to service credit in the Retirement System or to extend the Member's DROP participation period. There is no fiscal impact associated with the provision allowing 5 year purchase of service.

Herring/Lexin/DK

FILE LOCATION: NONE

COUNCIL ACTION: (Time duration: 2:31 p.m. - 2:53 p.m.)

CONSENT MOTION BY MADAFFER TO ADOPT. Second by Maienschein. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

* ITEM-133: Two actions related to Approval of Agreements on SDCERS Board Indemnification & City SDCERS Employer Contributions.

CITY MANAGER'S RECOMMENDATION:

Adopt the following resolutions:

Subitem-A: (R-2003-390) ADOPTED AS RESOLUTION R-297335

Declaring that the City of San Diego agrees to defend, indemnify and hold harmless the members of the Board of Administration for the San Diego City Employees' Retirement System in the performance of their duties.

Subitem-B: (R-2003-661) ADOPTED AS RESOLUTION R-297336

Authorizing the City to enter into an agreement with the San Diego City Employees' Retirement System regarding employer contributions.

CITY MANAGER SUPPORTING INFORMATION:

Board Indemnification: Section 141 of the San Diego City Charter created the San Diego City Employees' Retirement System (SDCERS). Section 144 provides that SDCERS be administered by a thirteen (13) member governing board known as the Board of Administration (Board), which includes three members elected by the General Members of SDCERS, one member elected by the retirees of SDCERS, two members elected by the Safety Members of SDCERS, one Police, one Fire, respectively, three ex-officio members: City Manager, City Auditor, and City Treasurer, and four citizen members, one of which must be an officer of a local bank, are appointed by the Council and serve without compensation. Charter Section 144 grants the Board the sole authority to determine the rights and benefits eligibility from SDCERS, administer SDCERS, and invest the SDCERS trust fund; SDCERS Board Members may, from time to time, be subjected to claims and suits for actions taken in their capacity as such.

Due to the need to protect and encourage individuals who volunteer their time and their talent to serve in the public interest, approval of the resolution provides that the City shall defend,

EXHIBIT 26

REPORTER'S TRANSCRIPT
OF VIDEOTAPE
RE: SAN DIEGO CITY COUNCIL MEETING
OF NOVEMBER 18, 2002
PAGES 1 THROUGH 19
TRANSCRIBED AUGUST 9, 2006

TRANSCRIBED BY JENELLE K. BARTEL, RPR, CSR NO. 12687

00002

(0:27:56 to 0:51:25)

MAYOR MURPHY: We're gonna go back to the other consent items or the other two consent items that were pulled, Item 50 and 51.

Fifty is an approval of an ordinance amending the San Diego Municipal Code relating to fiscal year 2003, negotiated retirement benefit enhancements.

Fifty-one is essentially the same related item dealing with the same subject.

We do have one speaker who wishes to speak in opposition on both 50 and 51. And we do have three people or two people here to speak in favor, although they indicated that they only need to speak if the matter -- if the matter was not heard on consent. So they may wish to be heard.

Let me ask the council. Anybody wish a presentation on 50 or 51? Yes? Okay. Mr. Peters would like a presentation, so --

MS. LEXIN: Thank you, your Honor. Item 50 is actually the second reading of an ordinance that was introduced three weeks ago that introduced the municipal code changes to affect the retirement enhancements that you have already approved in memorandums of understanding with the labor organizations. So that item is the second reading of that issue.

00003

Item 51 is the introduction of an ordinance amending the muni code with two provisions of benefit enhancements that weren't done in time for the first reading three weeks ago. So they're being introduced today. But in all cases, those are benefit enhancements that you approved through meet-and-confer this past spring.

MR. INZUNZA: Mr. Mayor, just so --

MAYOR MURPHY: Mr. Inzunza?

MR. INZUNZA: Real quick, I was in the back on Item 117 so I wanted to register a yes vote and I'd like to move Items 50 and 51 as well. Thank you.

MAYOR MURPHY: All right. The record will reflect Mr. Inzunza was -- was present on 117 and that he will be reflected as a yes vote.

There's a motion to approve 50 and 51. We still have to hear from the -- the public testimony. Is there a second? Okay.

All right. First we'll call on Diann Shipione to speak to 50 and 51.

MS. SHIPIONE: Thank you, your Honor.

MAYOR MURPHY: How much time are you requesting? We have two items here. I just --

MS. SHIPIONE: Three minutes. Four minutes (inaudible).

00004

MAYOR MURPHY: I can give you a total of six minutes because it's two items.

MS. SHIPIONE: Thank you. Thank you, your Honor. Thank you, Councilmembers. I appreciate your taking the time to listen to me today. I also appreciate your service to the community and I'd like -- I'd like you to all know that.

My name is Diann Shipione. I live at 7701 Exchange Place in La Jolla. I've been in the securities industry for over 15 years. I've been a trustee on the city's funds commission and also on the City of San Diego retirement system since 1997. I'm coming before you today because of concerns I have on the items related to the retirement pension plan.

Specifically these ordinances are proposing to once again lower the city's contributions to the already seriously underfunded pension plan. As you may know, the City of San Diego's pension plan is one of the lowest funded pension plans in the state currently. And that funding ratio is about to drop seriously due to market conditions, both the stock market and the bond market as well as due to the impact of increased benefits.

And my concern as a trustee is that this situation, if the city continues to underfund its

contributions, will lead to an astonishingly high bill to this pension plan in the year 2009 based upon this agreement, a bill that could really be sticker shock for the next council. I'm assuming if you're all reelected that most of you would be term limited out by that point, but it would -- could be a bill in multiple billions of dollars.

To date, it's my understanding that the city has underfunded the pension plan to the tune of around a hundred million dollars. That would be based on the actuary's report in arrears. So I mean, it doesn't include the impact of the market this year or the increased benefits that have recently been given.

And I've stated most of these concerns in a four-page letter which I gave to all of you. And I think that this whole issue has come about as a result of the negotiations that occurred in meet-and-confer last spring between the city and labor unions. The retirement board was not a party to those negotiations, but -- but apparently the benefit increases were conditioned upon the retirement board approving this agreement which allows the city to diminish its contributions to the pension plan yet again.

And our actuary has made it very clear that this is not a good idea; that the current agreement is

preferable; that we as trustees are responsible for ensuring the economic security and integrity of the retirement system.

And my second concern beyond the fact that the pension fund is underfunded and at risk and that some future council is going to be faced with a very large bill -- my second concern is the process, the methodology that was used to accomplish this agreement. And specifically what concerns me is that the benefit enhancements were conditioned upon the retirement board approving this agreement. And that's, in my opinion, ethically troubling. I would go even further. I would highly recommend that this go before the ethics commission and I'll be quite frank with you. It almost appears to be corrupt in my opinion.

So having said that, I think I -- I just basically would like the council to know my position on this as a trustee, that I'm deeply concerned with the economic stability and fiscal structure of our retirement system. And would ask you to look very closely at the letter that I've given you and would ask you to consider if you really are compelled to vote in favor of this to at least have the ethics commission review it prior to your voting on the motion. Thank you very much.

MAYOR MURPHY: All right. We'll ask the city manager or his representative to respond, but let me first ask if the other speaker -- other speakers wish to be heard.

Ron Saathoff, do you wish to be heard? And followed by -- Ron Saathoff representing the San Diego Fire Fighters Local 175 and 145.

And Ann Smith representing the MEA. I'm sorry.

Okay. Judy Italiano also?

FEMALE SPEAKER: (Inaudible).

Mr. Saathoff, you're on.

MR. SAATHOFF: Thank you, sir. Honorable Mayor, members of the city council --

MAYOR MURPHY: Are you -- I need to know do you want three or six minutes on this. You (inaudible) it is a two-item --

MR. SAATHOFF: Three should be adequate. I'll be very brief.

Basically, you know, I'm in support of both motions. They were -- they were negotiated by various bargaining groups and as part of the meet-and-confer process this year. I am fortunate to have served on the retirement board as an elected representative, oh, probably about 17 years now and have a long history of -- of being a trustee and working with that board.

And I will tell you that the way the process was just represented to you, in my opinion, does not state the fact correctly.

There was a recommendation by the city manager with regard to contribution rate relief given some of the budgetary constraints that this city faces and has faced but more -- more importantly faces today and into the future. The retirement board looked carefully at that proposal, had it reviewed by our system actuary and also by our onsite fiduciary council. In both cases, they opined that it was not prudent and that as trustees they would not recommend that we enter into that agreement and we did not.

There was a substitute motion made which actually was made by myself which put more burden upon the city in terms of contributions and in terms of how the entire structure of an agreement would be forthcoming. We sent that out to fiduciary council and to our actuary and both had opined that it was acceptable and that they -- they supported the position.

As far as there being a nexus between negotiations, when that substitute motion was made and approved by the board, the city manager's office went out to the various unions and said that we are not holding up anything. The agreements are good. We are

going forward with the benefits. And I might point out that the substitute motion was subject to an agreement to be negotiated between the city and the retirement board in the future.

So any -- any perception of a nexus, in my opinion, was gone at that point in time because, as I said, the benefits were conferred at that point. They were agreed upon at that point. And the agreement that we had entered into conceptually as a retirement board with the manager still had yet to be negotiated and had to be bought off on by our fiduciary council and by our system actuary. And that agreement has since been finalized and confirmed by the retirement board with the blessing of both the actuary and the outside fiduciary council.

So what was originally proposed is not what was done. There was a different mechanism put in place by the retirement board because the original was not acceptable.

And I might point out there was an attorney, Mr. Aguirre, who had threatened to sue the board had we adopted the manager's recommendations. And after the substitute motion was put into effect and passed, I went up to Mr. Aguirre after the -- after the discussion. I said, "Mr. Aguirre, does this satisfy your concerns?"

And he said, "Absolutely." You know, as far as I'm concerned, we did the right thing. It's an appropriate action and that was the end of the story.

So I just wanted to give you a brief background as to exactly what had occurred with regard to the agreement with the city on contribution rates.

And I'm here if you should have any questions you need answered, but other than that, thank you for the opportunity to speak.

MAYOR MURPHY: All right. Ann Smith? I'm sorry.

Judy, did you wish to be heard, too?

FEMALE SPEAKER: (Inaudible).

MAYOR MURPHY: Just put a slip in indicating that you support this.

Okay. Ann Smith representing the Municipal Employees Association.

MS. SMITH: Thank you. Ladies and gentlemen, I apologize I did not wear a suit. I did not expect that you would be on my calendar today because this letter that prompts our present discussion, I believe, was presented this morning. I have not seen all of the details of the letter, but I do understand that it contains, as Ms. Shipione herself referenced in her comments, some fairly provocative language including the

term "corruption."

And I wanted to come before you today -- I think the last time I was here was when we had an impasse hearing in May -- and assure you that through the last several months, MEA has followed the progress of all of the meetings and all of the discussions that relate to the benefit package that we negotiated which included improvements in the retirement system.

The retirement board in full, fair, open discussion and debate with advice from every qualified expert that needed to weigh in on the subject conducted its own discussions, evaluations, and debates at which time Ms. Shipione made her disagreements with some of those issues made known to her colleagues on the board.

It's my understanding that the board vote on the memorandum and indemnification provision with the city manager and the city was taken on Friday and Ms. Shipione was one of two dissenting votes. And the rest of her colleagues on the board including all of the private members of the board were in full agreement with the proposal and were satisfied with the terms that had been agreed upon.

For our part representing city employees, those employees have understood by virtue of all of the endeavors and good-faith efforts that have been made

that we had an agreement on benefit changes and that those agreements have been finalized. They are part of an MOU that you have had the first reading of and that city employees ratified. And we have many city employees who, operating in good faith themselves, are waiting to determine the course of their own lives, including retirement, based on those new benefits and the promise -- and the promises that have been made up to this point.

So I think that for this 11th hour letter to come to you today when these issues have been in full play for several months and certainly if there was going to be this type of a serious allegation made, which I think basically borrows the buzz words of the day and throws them all into a letter even though I haven't seen the whole contents of it -- to throw a monkey wrench into a very good faith, honest effort that has been made to deal with the city's financial issues and a fair new agreement for employees is really a questionable thing to do and -- and puts employees unfairly in the position of not having any certainty in their own lives and that's unfair to them.

And I would urge you not to let this kind of a letter that is brought at the last minute under circumstances that should be questioned as to why these

issues that have already been discussed by other members of the retirement board and by MEA and all of the other responsible people who have been involved in this process why you should have this at the 11th hour.

And I urge you not to let it delay or deter you in voting favorably on Item No. 50 and No. 51. I think it's the right thing to do and I've read Maddy's [phonetic] whole book of poems and I can tell you that he couldn't agree more with the proposition that this has been fair. It's been honest and it should be approved. Thank you.

MAYOR MURPHY: All right. That concludes all the speakers. Let me ask the city manager or his representative to respond.

CITY MANAGER: Yes, Honorable Mayor, members of council. Let me ask Cathy Lexin to describe briefly the process and then it might be appropriate for the city attorney to describe the legality of that process.

Cathy Lexin?

MS. LEXIN: Thank you, Mr. Manager. Just to be clear, the City Attorney's Office was involved throughout this entire process as well. And the agreement Ms. Shipione refers to is Item 133 on your consent agenda, not 50 and 51. Those are the benefit enhancements.

The agreement between the city and CERS was mutually developed between outside fiduciary council from CERS and the City Attorney's Office. And that agreement was approved, as others have said, on this past Friday with only the two dissenting votes.

In his 13-page fiduciary analysis and opinion and conclusion, Mr. Blum reviews the four different public meetings where these issues were completely explored and discussed in detail. And just to be very brief, he concludes in his legal review by saying, "It is our opinion that it is reasonable for the board to enter into this agreement in its exercise of its fiduciary responsibilities."

So we absolutely agree that the action before you today is within fiduciary responsibilities of the CERS board as well as the city council.

The city attorney Mike Rivo is here as well who was personally involved in drafting that agreement and if you have any questions of him, he can respond to those.

MAYOR MURPHY: Okay. Ms. Frye?

MS. FRYE: Just two questions that I -- I just would like to have clarified regarding the actuarial valuation and the -- the amount of the retirement system that might be currently underfunded. Is it an accurate

statement to say that it totals approximately a hundred million dollars?

MS. LEXIN: I -- I'm not sure what analysis Ms. Shipione's referring to, if she's talking about five years ago from the contribution rate agreement the city entered into. There was an amount of underfunding that is gradually being increased. The agreement before you today actually doubles the amount of contribution increases from the previous agreement which is partly why fiduciary council endorsed it in his review.

The retirement administrator is here who could answer more detailed questions about funding of the system than I can if you need that information.

Certainly the system's funding is -- has turned in the past two years due to primarily investment losses of the system's assets, but the city's contribution rates have continued to increase each year.

MS. FRYE: As far as the -- the pension plan, as far as how it was being funded and the -- the -- the amount that we were going to fund it, has that changed from the meet-and-confer? I mean, because Mr. Saathoff was talking about a substitute motion and I'm not clear on what that is. That was -- is -- is that -- what -- what is that substitute motion?

MS. LEXIN: Prior to the agreement before you

today, the city had an agreement with the retirement board that talked about contribution rates being below the actuarial amount until or if the system's assets dropped to a funding ratio below 82 percent. There was a point where the manager's office was asking the retirement board to lower that funding ratio trigger to 75 percent.

MS. FRYE: Correct.

MS. LEXIN: Fiduciary counsel and actuary advice was that was probably going further than might be deemed reasonable. And there was an amended motion by Mr. Saathoff to keep the 82 percent floor before we triggered the full actuarial contributions.

The agreement before you today maintains the 82 percent, but rather than going to the full actuarial rate next July, if it's triggered this year, we will reach the full actuarial contribution rate over a five-year period which the fiduciary and actuary deemed to be within the reasonable jurisdiction of the board to determine.

MS. FRYE: And if that number -- if that trigger -- because, again, this seems different to me than what was originally proposed. And so what would be the dollar amount that would be paid over a five-year period if that were triggered?

MS. LEXIN: Mr. Grissom is probably more appropriate to respond to those. I could give you my estimates.

MS. FRYE: Yeah, I don't need an exact figure, but just so I have some kind of an idea because this is, I must say, extremely disconcerting and because there was now a substitute motion that has been made, you know, on Friday and we're just learning about it --

MS. LEXIN: Well, ma'am, let me correct that. The substitute motion happened back in July. It was -- it was the agreement we reached with the board immediately after meet-and-confer.

MS. FRYE: So --

CITY MANAGER: If you recall we were -- when we were negotiating, we came in with a proposal as indicated by Cathy a few minutes ago that the floor could go to the 75 percent. Basically what the retirement board said and what the fiduciary said is they felt that that was not necessarily reasonable. We had to look at an alternate approach where the 82 percent ought to be maintained. That's what Mr. Saathoff just said.

So we came back to the city council. We said we're gonna have to put in some more money in it. It's got to be the 82 percent and hence then we followed

through with that. The board's just voted on the overall plan this last week, but that's been in discussion for the last three months.

MS. FRYE: Okay. As I said, it -- it does get confusing and one of the -- the difficult situations for an elected official is when some of these things are done in closed sessions, it's very difficult to get a -- a contrary opinion. Plus, it's difficult to discuss it because it was things that were brought forward in closed session. So that -- that's why I get a little --

CITY MANAGER: Let me say I totally agree with you. Obviously, we received this letter -- I received it about an hour ago. Had we received it last week or so, we would have had a written reply from my staff and the City Attorney's Office that would outline the exact process and you'd have all that information, exactly what happened, when it happened, and how it happened.

MS. FRYE: Okay. Because, like I said, I just feel like I don't know what I don't know right now and it's -- it's very disconcerting to me when -- when these types of issues are raised. I think they need to be (inaudible) so I'm -- I'm just having some problems right now.

MAYOR MURPHY: Okay. I see no other requests for questions. We do have a motion on the floor so I

suggest we vote. Call the roll. It passes 8-1 with District 6 voting no. Okay. That was both 50 and 51. That concludes the consent agenda.

* * *

(End of transcription as directed.)

I, JENELLE K. BARTEL, RPR, Certified Shorthand Reporter For the State of California, do hereby certify:

That the videotape recording was taken down by me in machine shorthand to the best of my ability and transcribed through computer-aided transcription and that the foregoing is a true record of the said videotape recording.

Dated: This_____day of _____, 20____, at San Diego, California.

_____

JENELLE K. BARTEL, RPR

C.S.R. NO. 12687

EXHIBIT 27

closed session 7/11/02

- Conflict of interest - memo re
mbrs voting on benefits they could enjoy -
- DS wants a new opinion
- Dian wants a current opinion
- Ray wants written indemnification
for this issue - nexus - clarification
Prop 162 confirmation w/
get written
explicit wording

fund any defense
joint & several until
applies in case of breach
"agreement contingent upon..."
" condit. on

Diann - still troubling
- approval of the agreement

DV -

SDC077008

EXHIBIT 28

NORMAN T. SELTZER
ROBERT CAPLAN
GERALD J. MCMAHON
REGINALD A. VITEK
STEPHEN DOUGLAS ROYER
DAVID J. DORSE
JAMES A. DAHL
BRIAN T. SELTZER
ELIZABETH A. SMITH
JOYCE A. MCCOY
DENNIS J. HICKMAN
JOHN R. ALSPAUGH
JAMES P. DELPHEY*
LEMOR T. MEREDETH
MICHAEL G. HARDY
THOMAS F. STEHNE
NEAL P. PANISH
SEAN T. MARGADEH
DAVID S. MINTON
DAVID J. FURSOFF
CHARLES L. GOLDBERG
PATRICK D. HALL
MICHAEL A. LEONE
DANIEL A. ANDRIST
J. SCOTT SCHIMEK
LEE C. NEJAHOWSKI
DANIEL E. EATON
LAURA H. ROPPE
M. CHRISTINE TENNISON
ANDREW D. BROOKS
PAUL A. DATHON
JOHN M. TOSCANO
MARNIE L. STEER
DAVID M. GREELEY
TROY A. KINGSHAVER
CHARLES O. WITHAM
ANDHOA C. CRANDALL
JACK R. LEER
JEFFREY D. HARRIS
SCOTT A. MILLER
KEVIN J. REISCH
LEMOR GOLDSMITH
ROBERT (ROBIN) M. TRAYLOR
MATTHEW M. MAHONEY
JOSEPH D. RADKIN
ELIZABETH B. CHARAPP
JASON A. HELSEL
JOSEPH P. MARTINEZ
AMANDA L. KRAMER
JOHN C. DIKEEN

OF COUNSEL
VICTOR A. VILAPLANA
LINDA PAPST de LEON
MONEY A. MCINTYRE
C. KIRK ELLIS
GREGORY A. YEGA
HOWARD J. BARSHOPSKY
JOHN C. BARRY

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March 5, 2003

VIA HAND DELIVERY

Sheila Leone, Esq.
San Diego City Employees'
Retirement System
410 B Street, Suite 400
San Diego, CA 92101

Re: San Diego City Employees' Retirement System, et al. adv. James F. Gleason, et al. - Initial Litigation Evaluation and Recommendations
San Diego Superior Court Case No. GIC 803779
Our File No. 7835.56570

Dear Sheila:

We have now had an opportunity to conduct an initial review and evaluation of certain documents pertaining to actions taken by the San Diego City Employees' Retirement System ("SDCERS"), by and through its individual board members ("the Individual Defendants") which serve as the factual foundation of the *Gleason* litigation. The categories of documents we have reviewed include:

(a) The *Gleason* complaint;

(b) Correspondence to and from SDCERS' fiduciary counsel regarding the 1996 City Manager's Retirement Proposal ("the '96 Agreement");

(c) Memoranda from the City of San Diego City Manager's Office regarding the '96 Agreement;

(d) Memoranda from the City Manager's Office regarding the City Manager's May 2002 contribution reduction proposal ("the '02 Proposal");

(e) Draft and final correspondence, and presentation materials, from SDCERS' fiduciary counsel regarding the '02 Proposal;

(f) SDCERS Staff Report regarding the '02 Proposal;

(g) Correspondence and presentation materials prepared by SDCERS' actuary regarding the '02 Proposal;

(h) Minutes of the SDCERS Board of Directors meetings on September 20, 2002, and November 15, 2002;

(i) Transcripts of the SDCERS Board of Directors meetings on June 21, 2002, July 11, 2002, and November 15, 2002;

(j) Agreement dated November 18, 2002, regarding Employer Contributions between the City of San Diego and SDCERS, including related resolutions regarding defense and indemnity of the Individual Defendants;

(k) Draft report on the Mayor's Blue Ribbon Committee on City Finances, dated January 15, 2003, including SDCERS staff response, and final version of "Blue Ribbon Committee" report, dated February 11, 2003.

We have also interviewed SDCERS' actuary, Rick Roeder, and spoken briefly with its fiduciary counsel, Bob Blum, Esq. We will meet with Mr. Blum to discuss his knowledge of the facts involved in this case on March 13, 2003. Finally, we have performed preliminary legal research to familiarize ourselves with the law governing SDCERS' rights, duties and obligations regarding the conduct at issue in the *Gleason* litigation.

Based on the foregoing sources of information, as well as our informal discussions with SDCERS staff, this letter will provide you with our initial analysis and recommendations regarding the defense of SDCERS in the *Gleason* litigation. As you know, our engagement is limited to representation of SDCERS, and does not include *any* of its board members, whether such board members are among the class of Individual Defendants or not. Moreover, our analysis, conclusions and recommendations are made exclusively from our perspective as litigation counsel. While we understand the *Gleason* litigation implicates highly politicized issues, our analysis does not take such factors into account, and instead focuses solely on what we believe is the litigation strategy mostly likely to achieve the best possible result for SDCERS.

Summary of Conclusions and Recommendations

Our conclusions and recommendations, as set forth in detail in this letter, are:

1. The Individual Defendants breached their fiduciary duty by adopting the '02 Proposal in its modified form because it resulted in a lower contribution obligation by the City, as well as an increase in vested liabilities, without any basis for accepting the City's contention that it would meet its increased contribution obligations in the final years covered by the '02 Proposal. It is unclear whether plaintiffs are asserting a breach of fiduciary duty by SDCERS, as contrasted with its Board.

2. The Individual Defendants subordinated SDCERS' interests to the interests of themselves, their unions, and the City.

3. SDCERS Staff should recommend to the Board that it exercise its right under the November 18, 2002 Agreement to "nullify this Agreement to the extent required by its duties established under the California Constitution..."

4. Notwithstanding the foregoing conclusions, SDCERS may be immune from liability for the acts alleged in the complaint under Government Code section 815.2. Depending on the strategy adopted after discussion between SDCERS and its litigation counsel, the initial responsive pleading may be a demurrer to the Complaint seeking dismissal of the action against SDCERS on the grounds it is immune from liability.

5. In the event it is necessary to answer the Complaint in the *Gleason* litigation, SDCERS should consider filing a cross-complaints against the City of San Diego and the labor unions whose leadership voted for the '02 Proposal, alleging a conspiracy between the City and Unions to cause the Board members to breach their fiduciary duties to SDCERS' members and their beneficiaries.

6. SDCERS should adopt a litigation strategy in the *Gleason* litigation designed to cause the City to honor its contribution obligations under the '96 Agreement.

Summary and Analysis of the Facts

B. The '96 Agreement.

In or about June 1996, the City Manager proposed an "Employer Contribution Rate Stabilization Plan," under which contribution rates would be calculated using the projected unit credit (PUC) actuarial method, with specified contribution rates in the ensuing two fiscal years of 7.08% and 7.33%. Thereafter, the contribution rate would increase by 0.50% each year until the contribution rate reached the rate calculated on the basis of the entry age normal (EAN) actuarial method. Significantly, the City Manager's proposal specified:

> "In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation...the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary necessary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation."

The City Manager's stated reason for presenting the "Rate Stabilization Plan" was the unanticipated fluctuations in the Employer's Contribution Rate under the projected unit credit actuarial method adopted by the City in 1992. Thus, all parties knew the City Manager's proposal was intended to effect changes to the retirement system *for the benefit of the City*.

The question of whether the Board would be discharging its fiduciary duties in adopting the '96 Agreement was submitted to fiduciary counsel for an opinion. Counsel noted that nothing in the proposal "changes the Board's discretion to adjust the actuarial assumptions on which the System is based as needed in order to insure the long term funding integrity of the System." Counsel concluded:

> "Provided the City-paid rate in the [Plan] is not less than an amount substantially equal to that required of employees for normal retirement allowances as certified by the actuary, the Board will be acting within the discretion granted to the Board to

> administer the System and discharging its fiduciary duties set forth in Article XVI, Sec. 17 of the California Constitution."

In response to questions from members of the Board, fiduciary counsel issued a second opinion addressing the System's duties under *Claypool v. Wilson* (1992) 4 Cal.App.4th 646, and related cases, to ensure that the modification of vested pension rights which would result from adoption of the City Manager's proposal were "offset" by an "increase in benefits and other advantages granted to the beneficiaries" of the System. Counsel noted that other aspects of the City Manager's proposal conferred increased benefits on the System's members. This, combined with the conclusion that "stabilization of employer contribution rates is directly related to the functioning and integrity of the system; led counsel to conclude the Board was acting in a manner consistent with its duties under *Claypool*.

In its second opinion letter, fiduciary counsel addressed two additional issues raised by Board members, which remain relevant to the current litigation. First, counsel noted the Board is held to the standard of professional bankers and bank investment advisors, and therefore has "a duty to determine the financial viability of the City before it approves contribution payments at a level less than that recommended by the actuary." Failure to carry out this duty, counsel noted, would be a breach of fiduciary duty. After reviewing the available information, counsel concluded a process existed through which the Board could satisfy itself of the City's financial viability.

Next, counsel noted that, because "the Board has no authority to determine benefits or to make benefit changes," it "should not engage in negotiations for benefit changes or increases." Nonetheless, certain Board members inquired as to whether the "real conflict" presented by Board members voting on proposals which would confer financial benefits on themselves would prevent those Board members from voting on the proposal. Fiduciary counsel noted that the City Manager's proposal made adoption of increased benefits contingent on approval of reduction of the City's funding obligation. However, counsel noted the drafters of the City Charter through which SDCERS was established "were aware of possible conflicts of interest inherent in the appointment of those [financially interested] members of the Board." Under these circumstances, counsel opined, the "bare potential for a conflict of interest does not categorically bar a fiduciary from functioning as a trustee." On this basis, counsel concluded:

> "[I]t is our opinion that those Board members who voted in favor of the proposal solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system, did not have a conflict of interest sufficient to bar him or her from functioning as a trustee."

According to Mr. Roeder, the performance of relevant financial markets during the 1996 through 2000 time frame caused the funding ratio to far exceed the "trigger" established by adoption of the '96 Agreement. Mr. Roeder noted it was generally accepted that the funding ratio trigger was 82.3%, but because the funding ratio never approached that level, certain potential ambiguities in the '96 Agreement were never resolved.

C. The 2002 City Manager's Proposal.

On June 10, 2002, the City Manager, on behalf of the Mayor and City Council, requested that SDCERS approve an amendment to the '96 Agreement as follows:

> "The floor for the actuarial funded ratio of SDCERS will be established at 75%.
>
> The City will pay contributions at the 'agreed to' rates for FY96 through FY07 as contained in the Manager's Proposal. If the actuarial funded ratio falls below the floor in any year, the City will increase its contribution rate on July 1 of the following year by an amount equal to one-fifth of the amount necessary to reach the full actuarial rate. The City will pay this increased amount for each of the subsequent for years in order to achieve the full actuarial rate over a five year period."

The City Manager identified as the basis for the proposed amendment several "unprecedented events" during the preceding two years, including 9/11, "the collapse of the dot com industry," the "overall fall in the investment market," the "specific loss of revenues in the San Diego economy, and the anticipated raid on local revenues by the State of California."

During the following week, SDCERS requested an opinion from its current fiduciary counsel, Bob Blum, Esq., as to whether adoption of the City Manager's proposal was consistent with the Board's fiduciary duties. In an unsigned draft opinion letter dated June 12, 2002, Mr. Blum summarized the circumstances which led to the City Manager's proposal, including: the total of contributions by the City and members to SDCERS was insufficient to cover the normal cost and interest on past service cost computed at the actuarial funding rate; from July 1996 to June 2002, the difference between actual City contributions and actuarially calculated contributions totaled approximately $90 million; and, "it is estimated that as of June 30, 2002, SDCERS funding ratio will be close to 82.3%."

Mr. Blum noted that since the '96 Agreement was executed, the law governing employees' interests in their retirement system had been "substantially strengthened," thus limiting the ability of employers to alter contribution obligations in a manner that affected vested benefits. Moreover, Mr. Blum noted that the ability to "mitigate" funding reductions through provision of "comparable new benefits" was "not governing with respect to the Board's responsibility to act prudently. If it were governing then each time that employer persuaded a Board to reduce contributions, it could avoid challenges by increasing benefits. That would not pass elementary actuarial requirements." Significantly, Mr. Blum noted that one of the questions left unanswered by the City Manager's proposal was the means by which the City would fund its contribution obligation under the proposed modification to the '96 Agreement.

After more than a dozen pages of analysis, counsel concluded:

> "Under the facts as we understand them, and for the reasons discussed above, *it is our opinion that there is a material risk that if the Board were to agree to the proposed amendment to the Manager's Proposal in its current form, and if this decision were challenged in court, a court would hold that the decision was not a proper exercise of the Board's fiduciary responsibilities based upon the facts before the Board and the actuaries [sic] opinion to the contrary.* A court would look at whether the Board had substantial evidence to support the propriety of its actions and there is a material risk that a court would find such evidence lacking." (Emphasis added.)

Also on June 12, 2002, SDCERS' actuary, Rick Roeder, made a presentation to the Board which was highly critical of the '02 Proposal. Among the most important points Mr. Roeder made were the fundamental inconsistency, from SDCERS' point of view, between the "enhanced benefits" aspect of the proposal, and the "contribution relief" aspect of the proposal. Mr. Roeder also laid out the following facts, which he felt were relevant to the Board's decision:

(a) SDCERS' role should be largely independent of the setting of existing or potential benefit levels;

(b) Existing benefits for City employees were not below average compared to other state and national public systems;

(c) SDCERS is one of the few retirement systems to use PUC funding, and on that basis has one of the lowest funded ratios in California; moreover the existing funded ratio is at its lowest point since the 1980's; and

(d) The gap between the computed PUC actuarial rate and the city contribution rate has been increasing since implementation of the '96 proposal.

Mr. Roeder also noted several mitigating factors. Foremost among them, it appears, was that SDCERS would "be able to make benefit payments over the next 10-15 years regardless of the decision made to grant potential additional funding relief."

In his presentation to the Board, Mr. Roeder stated, "What the City proposes is outside the norm for generally accepted actuarial funded policies," a circumstance which he felt "place[d] an added burden in our view as trustees to exercise our fiduciary responsibility appropriately." Mr. Roeder stated that if the Board was "willing to accept this version of the manager's proposal, I want everyone here to be totally cognizant of the fact that the way I understand the current version is it will [be] possible for the funded ratio to go below 75 percent and possibly significantly below." Finally, Mr. Roeder made clear he was more comfortable with the initial manager's proposal because of the "hard floor" of 82.3%

Transcripts of the June 2002 hearing indicate a difference of opinion existed among both Board members and Staff regarding the proper interpretation of the '96 Agreement's "catch-up" provisions; particularly, whether the entire underfunded

amount came due in the immediately following year, or whether some longer term applied. Mr. Blum, along with Mr. Roeder, noted that under reasonably anticipated circumstances, a one-year catch-up provision would require the City to contribute approximately $75 million in FY03, if the funded ratio fell below 82.3%, as it was expected to do.

On June 18, 2002, the City Manager issued a memorandum to SDCERS purporting to respond to concerns raised by Mr. Blum in his June 12 draft correspondence. There appears to have been no attempt to respond to Mr. Roeder's concerns as expressed in his presentation. Significantly, despite Mr. Roeder's concerns over "dropping the hard floor" from 82.3% to 75%, the City Manager's memorandum left that provision unchanged. Additionally, the City Manager responded to Mr. Blum's concern regarding "funding status and anticipated earnings" over the later stages of the '02 Proposal's life by stating:

> "This is a very broad question which includes the work initiated by the Mayor's Blue Ribbon Committee on City Finances, the SDCERS subcommittee on surplus earnings and contingent benefits, and the need to develop a long term funding policy. It is recommended that a plan and schedule be developed to complete this policy work."

The only substantive modification to the original proposal was an increase in the City's "agreed contribution rate" from 0.50% to 1.00% effective July 1, 2004. This proposal is, at the very least, puzzling in light of the City Manager's non-response to Mr. Blum's questions concerning financing, and the City's purported justification for seeking contribution reduction in the first place, i.e., that it expected the State to "raid" City revenue sources beginning in 2004, thus worsening its short-term financial outlook.

On July 3, 2002, the City Manager provided SDCERS with another memorandum "clarifying" the terms of the proposal, as well as responding to concerns by Board members. Significantly, the City Manager's "clarification" made clear that the City had agreed to increased benefits for its employees during labor negotiations, "contingent" upon SDCERS accepting a reduction of its contribution obligation; yet in response to a Board member's question as to why SDCERS was placed in the middle of labor negotiations, the City Manager denied such a thing had occurred. Also significant was the City Manager's response to the Board's question of "why

we should assume the City will find it easier to pay much higher pension costs in the future."

"It will not be easier nor desirous, just necessary."

No further information was provided as to how the City would meet the contribution obligation outlined in its proposal.

On July 11, 2002, another Board meeting was held at which SDCERS' fiduciary counsel provided an analysis of the effect of the "changes" the City offered in an effort to gain acceptance of the '02 Proposal. Mr. Roeder made clear at the July 11 meeting that the 82.3% trigger would be hit in June 2003. Thereafter, the Board devoted its discussion to the difference in funding obligations between competing interpretations of the '96 Agreement and the '02 Proposal. After lengthy and detailed discussions, Mr. Saathoff proposed that the 75% trigger in the '02 Proposal be replaced with the existing 82.3% trigger. Additionally, the modified proposal would incorporate the provision in the original '02 Proposal giving the City five years after the trigger was hit to "reach the full actuarial rate."

In the final minutes of what was a very long meeting, before a vote was taken, the Board asked both Mr. Roeder and Mr. Blum whether adopting the proposal was "a prudent exercise of our responsibility." Mr. Roeder appears to have responded that the final version of the proposal fell somewhere between the '96 Agreement and the original '02 Proposal. Mr. Blum stated it was difficult to give "an on-the-fly opinion," before concluding:

> "I can tell you it's a lot easier to give an opinion that you would not be at material risk. Exactly how far that opinion can go, exactly what the words are, that's a little difficult to tell you because we don't have the facts."

A vote was taken immediately thereafter, in which the modified '02 Proposal passed 8 to 2, with one abstention.

On November 5, 2002, Mr. Roeder provided certain written "statements in regard to the amendment to the Manager's Proposal." From the perspective of the current litigation, the most significant statements Mr. Roeder made were:

> "(c) It is likely that the 82.3% trigger point will be hit by June 30, 2003,..."
>
> "(d) The higher the City's contribution levels, the better the funding status of SDCERS..."
>
> "(g) From a pure actuarial viewpoint, it would be best to hold the City to the existing Manager's Proposal and the 82.3% trigger (particularly if one of the two 'high contribution rate' interpretations of the effects of hitting the trigger were to prevail)."

Mr. Roeder's letter did not include any statement to the effect that adoption of the modified '02 Proposal conformed to generally accepted actuarial principles, or that it was a prudent exercise of the Board's fiduciary responsibility.

On November 15, 2002, Mr. Blum reported to the Board on the results of his negotiation with City representatives on the provisions of the Memorandum of Understanding that set forth the final terms of the modified '02 Proposal. The Board discussion centered on assumptions underlying the exemplar calculations in the Memorandum of Understanding. Additionally, the first mention was made of "indemnification" of the Board by the City from unspecified consequences of adopting the modified '02 Proposal. Transcripts of the hearing indicate the discussion became extremely contentious and acrimonious. It appears from both the minutes and transcript that the Board concluded Mr. Blum essentially supported adoption of the MOU because the Board had engaged in prolonged and difficult evaluation of the proposal before adopting it. However, at least one Board member acknowledged that Mr. Roeder was "hesitant" to endorse the proposal. Mr. Roeder confirmed this interpretation of his feelings, stating that he felt it was "inappropriate" and placed the Board in "a no-win situation" of evaluating a contribution relief proposal that was linked to enhanced benefits for members. Nonetheless, the Board voted to adopt the MOU.

On November 18, 2002, Mr. Blum provided SDCERS with a signed opinion letter, containing an extensive, albeit retrospective, summary and analysis of the Board's decision to approve the modified '02 Proposal. Mr. Blum summarized the Board's decision as follows:

> "In essence, the Board decided to trade potential controversy over the meaning of the current Manager's Proposal and the possibility of receiving substantially higher contributions from the City if the

> 82.3% trigger is met in exchange for materially higher contributions if the trigger is not hit, lower contributions in the first five years if the trigger is hit, a date certain when the full PUC rate is contributed, and agreement on rapid movement to EAN starting at the end of the transition period."

Despite Mr. Roeder's multiple criticisms of the '02 Proposal (see page 11), Mr. Blum's only mention of Mr. Roeder's analysis was that the "transition period of moving the City to full PUC rates and then to EAN rates is reasonable based on the terms of the Agreement." Mr. Blum's reference to this limited aspect of Mr. Roeder's overall conclusion is puzzling, since Mr. Roeder explicitly stated that "from a purely actuarial viewpoint," he preferred there be no transition period.

On November 18, 2002, SDCERS executed the Agreement adopting the modified '02 Proposal. Significantly, the recitals included a statement that SDCERS recognized that "under current fiscal circumstances, undue hardship would be imposed on the City if the Board were to require that the City immediately increase its contributions to the full projected unit credit rate calculated by SDCERS' actuary." Also significant was a previously little-discussed provision allowing the Board to "nullify this Agreement to the extent required by its duties established under the California Constitution and no one shall have any liability for losses or costs on account of such action."

On the same date, SDCERS and the City executed an indemnity agreement, which provided "the City shall defend, indemnify and hold harmless all past, present and future members of the Retirement Board against all expenses, judgments, settlements, liability and other amounts actually and reasonably incurred by them in connection with any claim or lawsuit arising from any act or omission in the scope of the performance of their duties as Board Members under the Charter."

Summary of the Litigation

D. The Complaint.

The *Gleason* litigation was filed by attorney Michael Conger on January 16, 2003. Plaintiffs are by two retired San Diego City employees, purportedly acting on behalf of an alleged class of similarly situated retired San Diego City employees. Defendants are the City of San Diego, SDCERS, and certain members of the Board of SDCERS, including Frederick Pierce, IV, John Torres, John Casey, David Crow, Mary Vattimo, Ron Saathoff, Terri Webster, Sharon Wilkinson, Dick Vortmann, and Ray Garnica (collectively: "the Individual Defendants").

The lawsuit alleges the City of San Diego violated certain sections of its Charter, as well as related sections of the City of San Diego Municipal Code, by failing and refusing to contribute actuarially appropriate amounts to SDCERS. Specifically, the lawsuit alleges "[t]he funding method adopted by CERS [sic] and the individual defendants is not one of the six approved funding methods permitted under the rules set forth by the Governmental Accounting Standards Board." The allegations focus primarily on the City's alleged violation of the cited provisions of its Charter and Municipal Code by failing to contribute funds to SDCERS according to the terms of the '96 Agreement, and thereafter obtaining a greater reduction of its contribution obligation through the adoption of the '02 Proposal.

The lawsuit seeks declaratory relief in the form of a judgment that the City violated the terms of its Charter and relevant provisions of its Municipal Code, and that SDCERS' Board and the Individual Defendants breached fiduciary duties owed to the plaintiff class. The lawsuit also seeks restitution from the City of San Diego of all amounts owed to SDCERS as a result of past violations (an amount estimated in the hundreds of millions of dollars), injunctive relief prohibiting further unlawful underfunding, money damages for retirement benefits which would have been paid to the purported plaintiff class but for the alleged violations, money damages from the Individual Defendants for damages proximately caused by their alleged breach of fiduciary duty, and removal of the Individual Defendants from the Board of SDCERS.

E. SDCERS Proposed Response to the Complaint.

The complaint makes clear that both the Individual Defendants, as members of the SDCERS Board, acted in their official capacity when they entered into the Agreement which is the subject of the *Gleason* litigation. For this reason, we think

that both the Individual Defendants, and SDCERS, may be immune from liability for the conduct at issue in the complaint, pursuant to Government Code sections 820.2, 821, and 815.2, respectively. We are presently researching whether any exceptions exist to these immunity statutes based on the nature of the alleged misconduct. If no such exceptions exist, it may be appropriate to demur to the complaint.

Before making this decision, however, consideration should be given to whether it is in SDCERS' best interests to extricate itself from the litigation at this early stage. While this may seem on its face to be counterintuitive, the underlying reasoning is as follows. The plaintiffs' objective is primarily to obtain funds from the City, both in the form of past contributions which were "wrongfully withheld," and increased future contributions. To the extent the complaint could achieve this form of relief, SDCERS would benefit. If SDCERS were to extricate itself from the litigation at the pleading stage, it would lose its status as a party, and its ability to affect the outcome of the litigation, which likely will be accomplished through the mediation process. Of course, the litigation would proceed against the City; therefore, the potential benefit to SDCERS from a judgment in favor of the plaintiffs would not disappear should SDCERS successfully demur to the complaint. Nonetheless, as you are aware, not being present at the "mediation table" with the City can have serious adverse consequences for SDCERS.

By electing not to demur to the complaint, SDCERS would not lose its ability to raise the immunity statutes as a defense. Such statutes can be pleaded as affirmative defenses in an answer, and thereafter be used as the basis for a motion for summary judgment which could be filed in the event early mediation proved unsuccessful. We intend to discuss this strategic decision with you in further detail once you have had an opportunity to review this letter.

F. Post-Demurrer Litigation Analysis

While we believe a reasonable probability exists that this matter could be dismissed as to SDCERS at the pleading or summary judgment stage, it nonetheless is necessary to advise you of our opinions as they relate to issues likely to arise in the post-pleading phase, should the case advance that far.

In the event the Court concludes SDCERS is not immune from liability, it will be necessary to answer the complaint and proceed with discovery. At the time the answer is filed, however, consideration should be given to filing a cross-complaint

alleging conspiracy between the City and Unions to cause SDCERS' Board members to breach their fiduciary duties to its members and their beneficiaries. While this may seem antithetical to SDCERS' custom and practice in its dealings with the City, it highlights the significantly different circumstances forced on SDCERS by the filing of the *Gleason* litigation.

As we advised in the preceding section, SDCERS' interests arguably are aligned with plaintiffs' interests, at least to the extent that increased contributions by the City would benefit SDCERS. However, although SDCERS' interests are aligned with plaintiffs', its status as a defendant does not allow it to control the manner in which claims for such relief are prosecuted. For example, plaintiff counsel could settle with the City on the basis of ill-defined promises of future remedial action, combined with a large amount of attorney's fees for procuring such "relief." Under such circumstances, SDCERS would gain none of the advantage from the litigation to which it is arguably entitled. Filing a cross-complaint would confer standing on SDCERS to control the manner in which relief is sought, and potentially granted, rather than relying on plaintiffs to obtain all appropriate relief.

A cross-complaint against the City and Unions would be based on information that indicates certain union representatives obtained benefits for themselves and co-members of their union as part of the negotiation process over adoption of the modified '02 Manager's Proposal. If proven, this would support the conclusion that these individuals breached their fiduciary duty to SDCERS by approving a plan which included enhanced short-term benefits for themselves, while at the same time allowing the City to reduce its contribution to SDCERS.

Our recommendation in this regard also results in part from our conclusion that SDCERS Board members breached their fiduciary duty by executing the November 18, 2002 Agreement. As you are well aware, the California Constitution requires SDCERS Board members must discharge their duties for the exclusive purpose of providing benefits to participants and their beneficiaries, while also minimizing employer contributions and defraying reasonable expenses of administering the system. However, where these objectives conflict, the duty to participants and beneficiaries takes precedence over any other duty. Based on our analysis of the available information, we believe a trier of fact would conclude that the only party to the November 18 Agreement that obtained any benefit therefrom was the City, in the form of long-term contribution relief. All available actuarial analyses show SDCERS will receive substantially less money under any version of the '02 Manager's Proposal, when compared to the '96 proposal. Parenthetically,

we believe the justification for adopting the '02 Proposal based on avoiding "uncertainty" over the terms of the '96 Agreement is insufficient to justify adoption of the '02 Proposal. Regardless of which interpretation was applied to the '96 Agreement, if SDCERS stood to gain between $25 and $75 million based on what its actuary and fiduciary thought was a reasonable interpretation of the '96 Agreement, it is difficult to accept the proposition that an "advantage" was gained by agreeing to a proposal that not only abandoned the arguable right to a $25 to $75 million contribution, but locked in a significant reduction in contributions over the following 8 years.

In addition to agreeing to a reduction in the City's contributions, SDCERS Board members accepted the November 18 agreement knowing its acceptance was a prerequisite to the City's agreement to pay increased benefits to certain of its unions. Thus, the Board agreed to a proposal that not only increased the vested benefits for which it was or would become liable, but at the same time impaired SDCERS ability to meet those obligations by accepting a reduced contribution obligation by the City.

Further on this issue, there appears to have been only limited inquiry into the means by which the City would ramp up its contributions over the term of the November 18 Agreement to meet the "agreed" contribution rate by 2009. The record shows the City sought contribution relief because of the near-certainty that the 82.3% funding ratio trigger would be hit by June 2003. Moreover, the City provided further justification for the requested contribution relief in the form of statements to the effect that its revenue in 2004 would be even less than in 2003, by virtue of the State "raiding" the City's revenue sources to pay for its own budget deficit. As SDCERS' fiduciary advised it when the '96 Agreement was adopted, the Board members are held to the standard of a professional banker, and must evaluate the financial condition of the City, before agreeing to grant it what amounts to debt relief. Yet here, the City offered no information to support its contention that it would somehow be able to contribute more to SDCERS between 2005 and 2009 than it ever had in the past, and thus reach the actuarially calculated contribution rate by 2009.

We anticipate that regardless of whether SDCERS prevails at the pleading or dispositive motion stage, and thus is no longer a party to the litigation, the foregoing facts nonetheless will come out in discovery. Our review of the record leads us to conclude little, if any, evidence exists that Mr. Roeder provided the necessary actuarial support for the Board's adoption of the '02 Proposal. Our

interview with Mr. Roeder confirmed this conclusion. We anticipate that when plaintiffs depose Mr. Roeder, he will testify that the November 18 Agreement was not based on actuarially sound conclusions, and that it will result in substantially lower contributions by the City to SDCERS than would have resulted had the '96 Agreement remained effective.

We have not yet had an opportunity to interview Mr. Blum and Ms. Hiatt. Therefore, we have not been able to ascertain what substantive changes to the initial '02 Proposal convinced them to change their draft opinion, which stated adoption of the '02 Proposal would be a breach of SDCERS Board members' fiduciary duty, to their November 18 opinion, which appears to support the Board's decision. The absence of clear and specific facts supporting this turnabout leads us to conclude Mr. Blum's final opinion letter may be insufficient to protect SDCERS Board members from a finding that they breached their fiduciary duty.

Conclusion and Recommendations

The record we have reviewed clearly shows SDCERS was backed into a corner by the City, which agreed to provide enhanced benefits to its union members, and thereafter sought to "pay" for these benefits through reduction of its contributions to SDCERS. The City's enhanced benefits proposal to its unions was expressly contingent on SDCERS' agreement to reduction in the City's contributions. In essence, the City and unions forced SDCERS into precisely the circumstance its fiduciary counsel and actuary considered highly improper: linking benefit enhancement with contribution relief. Furthermore, the inherent and recognized conflict under which certain SDCERS Board members operate appears to have been exacerbated by the inclusion of additional benefits for those Board members during the negotiation process.

To avoid a continuation of this inherent conflict during our representation of SDCERS in the *Gleason* litigation, we recommend SDCERS form a litigation committee to direct its defense of this litigation. Our review of SDCERS' Charter indicates it cannot act without a quorum of its Board. In light of the fact the majority of its Board are Individual Defendants, and are separately represented, the composition of the litigation committee is a difficult question, and lacks clear precedent. Nonetheless, we believe the committee should be comprised of the Board president, at least one senior Staff member and Staff counsel, and Board members who have the fewest possible ties to either the City or the unions. This would allow a relatively "disinterested" litigation committee to make

recommendations to the Board on important decisions to be made in defending against the *Gleason* litigation. In this manner, the influence of "interested" (and potentially conflicted) parties would be at least minimized, thus increasing SDCERS' ability to defend this action in a manner consistent with its Constitutional mandate.

If the "litigation committee" format proves unworkable, SDCERS may be able to adopt a course of action similar to that used by corporations defending against derivative lawsuits in which a quorum of disinterested directors cannot be assembled. In such circumstances, the corporation will sometimes hire a "litigation representative" whom it empowers to act on its behalf in directing and controlling the litigation. We have not yet researched whether SDCERS' rules of governance would permit it to designate an independent third party as its litigation representative in this action, but would be happy to do so if you so choose. Potential candidates for such a position would include retired judges such as Hon. Lawrence Irving, or Hon. Howard Wiener, or other individuals with an outstanding reputation for ethical conduct and business judgment.

In light of our conclusion that SDCERS Board members breached their fiduciary duty to its members and their beneficiaries by executing the November 18 Agreement, we believe it should adopt a litigation strategy designed to obtain an increased contribution obligation from the City. The first step in this process would be to exercise its right under the November 18 Agreement to "nullify" the Agreement. Thereafter, SDCERS should work with its actuary to produce a defined contribution schedule which meets SDCERS' obligations to its members and their beneficiaries in a manner consistent with other public agencies in this State. This actuarial calculation should then be used as the basis to obtain a new contribution agreement from the City in the context of mediation proceedings in this litigation.

We believe mediation is appropriate in this matter both because it would avoid a finding that SDCERS Board members breached their fiduciary duty to its members, as well as because we believe this will not be the last lawsuit Mr. Conger files as a result of the November 18 Agreement. As members of Staff have made clear to us, SDCERS has sufficient funds to meet its current obligations to the class of retirees. What Mr. Conger appears to not yet appreciate is that the November 18 Agreement compromised the interests of *future* SDCERS members much more than those of *existing* members. That is, from Mr. Conger's perspective, he has the "right" lawsuit, but the wrong plaintiff class. We suspect this fact will not be lost on Mr.

Conger forever. In the meantime, the defendants enjoy a small strategic advantage in developing a strategy that would eliminate the potential for a second lawsuit on these facts while plaintiff counsel remains apparently unaware of the possibility of such a lawsuit. Developing a litigation strategy, as outlined above, that incentivizes the City to cooperate in reaching that goal is therefore of paramount importance.

As everyone is well aware, this is an extremely complicated matter, with ramifications reaching far beyond the limited scope of the *Gleason* litigation itself. We recognize that our analysis and recommendations may be inconsistent with SDCERS' political objectives, and we cannot offer any guidance on how to reconcile the two. Nonetheless, having been forced into litigation over what was originally a political and legislative issue, SDCERS must now formulate a litigation-based strategy for dealing with its current circumstances. After reviewing this letter, we would appreciate an opportunity to meet with appropriate SDCERS representatives to discuss this issue further.

Thank you for your attention to this matter. We look forward to hearing from you.

Very truly yours,

Reg A. Vitek
Seltzer Caplan McMahon Vitek
A Law Corporation

MAL/RAV:bs
cc: Michael A. Leone, Esq.

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EXHIBIT 29

I 1.2.12

Memorandum

333 Market Street, Suite 2300, San Francisco, CA 94105-2173
Tele: (415) 777-3200, Facsimile: (415) 541-9366

HANSON BRIDGETT MARCUS VLAHOS RUDY LLP

TO: RAB

FROM: MNC

DATE: February 20, 2004

RE: **San Diego City Employees Retirement System—Analysis of Conflict of Interest Issue**

You have asked me to examine whether the approval of an agreement between the City of San Diego and its Retirement System may have resulted in a violation of Government Code Section 1090, which prohibits public officials from having a private interest in the contracts they participate in making[1] or which are made by a board or body of which they are members.

I. Background

Article IX of the San Diego City Charter provides for the establishment of a "City Employees' Retirement System" (System). Section 144 of the Charter provides for a "Board of Administration" (Board) to manage the System. The Board consists of the City Manager, City Auditor and Comptroller, City Treasurer, three members of the System (elected by the membership), one retired member of the System (elected by the retired membership), an officer of a local bank and three other citizens of the City. As a result, seven of the eleven members are presumably persons who are either current or prospective recipients of benefits of the System and may therefore (to the extent the decisions affect benefits or the ability of the system to pay them) have a financial interest in contract made by the Board. In addition, six of the eleven members are employees of the City, and thus have a financial interest as a result of the salary and benefits they receive from City, which may be relevant in any contracts they might approve with the City. Nevertheless, the City Charter provides for these individuals to make significant financial decisions for the System, including arrangements with the City for the transfer of funds necessary for the funding of the benefits the System is to provide.

In 2002, as a result of negotiations with labor unions representing City employees, the City entered into union agreement(s) providing for certain increases in benefits to its employees. Following the tentative approval of those agreements and in order to implement the increased benefits incorporated within them, the City sought to modify certain arrangement(s) it had with

[1] Section 1090 reads in part: "Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members."

the System. As a result, the City and the System entered into an agreement that changed the terms of a prior agreement re contributions to the System.

II. Legal Analysis

A. Government Code 1090

Section 1090[2] of the Government Code provides that no officer or employee of a public agency may have a financial interest in a contract "made" by them in their official capacity, or by any body or board of which they are a member. Included in this prohibition is almost any aspect of participation in the formation of the contract, including influencing the development of the contract. In addition, a member of a legislative board or body is conclusively presumed to have such an interest in any contract approved by that body, even if the member has disqualified his or herself from participation in that action.

1. Elements of a Section 1090 Violation

The elements of a violation of Section 1090 consist of: (1) a contract; (2) which is developed or negotiated by persons subject to the statute, or approved by a body or board of which they are a member; (3) when such persons have a financial interest in the contract. There are two categories of exemptions to Section 1090, consisting of "remote interests" (which are defined in Section 1091 and require disclosure and non-participation by the individual with the interest) and "non-interests" (which are defined in Section 1091.5 and generally do not require either disclosure or non-participation.) We will look at each of these elements of a violation with regard to the Board's approval of the agreement with the City, then consider the various exemptions.

a. Contract

A required element of a 1090 violation is that a contract have been entered into by a public agency. (Other statutes, such as the Political Reform Act (Gov't. Code §§ 81000 et seq.) address conflicts of interests in a wider range of governmental decision-making actions.) It is clear that a formal arrangement was entered into between the City and the System. However, in order to determine if this arrangement is indeed a "contract," we must look at the exact nature of the relationship between the City and the System and the terms of the agreement.

As an entity that is created by the City Charter, the System could be viewed as constituting a legal subdivision of the City. While it may have independent fiduciary responsibilities to the System's beneficiaries, the System is not an agency established under any other governmental authority (such as separate enabling legislation enacted by the Legislature). As such, it may merely be a separate subordinate entity within the City government that

[2] All statutory references are to the California Government Code unless otherwise noted.

technically can not "contract" with the City because it is part of the City.[3] Therefore, we must first consider whether the agreement between the City and the System may not be a "contract" at all for purposes of Section 1090, but merely an internal arrangement within a single governmental entity.

A number of cases have examined situations in which there was uncertainty as to the separate identity of affected governmental entities. In People v. Gnass (2002) 101 Cal.App.4th 1271, (a case coincidentally involving a Section 1090 violation) the court addressed a situation where an attorney represented a two related public entities and then received fees as the result of a bond transaction from a third related agency for which he served in a private capacity. In his defense, the attorney attempted to separate the agency that paid him as a private counsel from others that he represented as a public official.

Gnass was City Attorney for the City of Waterford, and also represented the Waterford Public Financing Authority (Waterford PFA), a joint powers authority (JPA) that was formed by the City and its redevelopment agency. The Waterford PFA then participated in the formation of a series of other JPA's that issued bonds to fund various projects around the state pursuant to the Marks-Roos law (the "Marks-Roos JPA's"). Gnass received legal fees as a disclosure counsel for the bond offerings made by the Marks-Roos JPA's. It was alleged that this arrangement violated Section 1090, because the Waterford PFA had entered into contracts with the various Marks-Roos JPA's that ultimately resulted in the payment of legal fees to Gnass as disclosure counsel in the bond financing. In reaching its conclusion that Gnass had acted in his public capacity in "making" the contract that had a private benefit to him, the court found that the "nice legalistic differences" between the City and the Waterford PFA were "not determinative" of the matter, since Gnass had essentially served, at one time or the other, as the attorney for both agencies. It was not necessary to find that Gnass had served in an official capacity for the Marks-Roos JPA's, although the court hints he may have done that as well.

In essence, the court in Gnass looked beyond the separate status of the agencies to find that he had represented the Waterford PFA in his public capacity in its formation of the Marks-Roos JPA. This resulted in a prohibited interest as a result of his expectation of receiving legal fees related to the bond financings for which the Marks-Roos JPA were formed. Thus, in this situation, the court compressed the separate legal entities into a single group interest in order to find that the attorney had been disloyal to his public office. However, this may not have been entirely necessary as the court appears to have reached its conclusion on the basis that Gnass represented the Waterford PFA while it entered into contracts to form the various Marks-Roos JPA's, knowing that he would receive fees in completing the bond deals of these JPA's. Nevertheless, if the Gnass court's reasoning regarding the identities of the various entities were to be applied in this case, a court might also avoid finding any "legalistic differences" between the

[3] In other large cities, agreements between separate agencies within the city are often termed "Memoranda of Understanding," between subordinate agencies of the city (as opposed to "contracts" between separate legal entities).

City and the System by viewing the bodies as a single entity (and therefore finding no prohibited contract):

In making its holding, the Gnass court refused to rely on two cases cited by the defendant, in which courts declined to view related entities as having a single existence. In both cases (Rider v. City of San Diego (1998) 18 Cal.4th 1035 and Vanoni v. County of Sonoma (1974) 40 Cal.App.3d 743), the courts refused to apply debt limitations applicable to one agency to the actions of a separate but related agency on the grounds that the second agencies had a separate statutory basis. In the Vanoni case, the Court noted that the Legislature had specifically provided for the formation of a "Sonoma County Flood Control and Water Conservation District" that was separate and apart from the County of Sonoma, despite having the same boundaries, a shared governing board and having its taxes collected in the same manner. In the other, the court found that a JPA formed by the City of San Diego and the San Diego Unified Port District was indeed an entity separate from the City. (The statute permitting the formation of JPA's clearly provides that they may be separate legal entities from their member entities. *See* Gov't. Code § 6507.) In both cases, the courts made it very clear that the statutory authority for the creation of each independent agency was an important determining factor.

There is statutory authority for cities to create retirement systems that do not involve the creation of a separate entity (*See* Gov't. Code § 45300 et seq.). However, the System was created and organized under the Charter.[4] Nevertheless, the argument that the System is a component part of the City is certainly bolstered by the fact that the legislation authorizing the formation of an analogue system does not provide for it to be a separate government entity. (Section 45316 notes that it is an alternate procedure and case law has held that Charter cities are free to adopt pension plans that differ from the statute. (Bellus v. City of Eureka (1968) 69 C.A. 2d 353)). Therefore, based on Vanoni and Rider, as well as the statutory framework for municipal retirement systems, a court should conclude that the System is part of the City and an agreement between the City and the System is not a contract for purposes of Section 1090.

A recent Attorney General's opinion addressed potential contracts between a city (San Francisco) and a for-profit corporation that was entirely owned by the city, when the City's Airport Director and a member of its Airport Commission, acting in those capacities, participated in the making of the contract while also serving as members of the board of directors of the non-profit. Finding that the two individuals in both roles would be acting in the best interests of the city, the Attorney General's office opined: "We do not believe that Section 1090 has any application where the contract is between a public agency and its wholly-owned corporation, regardless of whether is non-profit or for-profit." (81 Ops.Cal.Atty.Gen. 91, 93.) It should be noted that this opinion was based, in part, on the fact that the two individuals "will not be receiving any personal gain" as a result of the contract and therefore would have undivided

[4] There are other statutes that establish certain other retirement systems (*See* Gov't. Code § 9320 et seq. (Legislative Employees); § 31450 et seq.) (County Employees)).

loyalty to the city while acting in both roles. (That may not be the case with regard to the System, since the board members will receive benefits from System. Therefore, placing too much reliance on this opinion may be risky.) The Attorney General also notes that he would decline to apply 1090 where it "would not serve the purposes of the Legislature in enacting section 1090" despite the absence of a clear statutory exemption. (Id. at 94.) Hopefully, a court would take a similar stance with regard to the System. Even if a court were to find that the System was a separate entity from the City, there is legal precedent for finding that 1090 might not apply.

b. Contract was Developed, Negotiated or Approved by Persons Covered

A second element of a potential 1090 violation requires that the contract be "made" by a person (or a body or board of which that person is a member) who is covered by Section 1090. Section 1090 has a wide reach. According to the California Attorney General's publication on the subject "[v]irtually all board members, officers, employees and consultants are public officials within the meaning of section 1090." The aspect of "making" the contract can involve a wide range of actions, including preliminary discussions, negotiations, reasoning, planning, and advising with regard to the subject of the contract.

(i) City didn't intend for 1090 to apply to Board

While it may appear that the City/System agreement was made by individuals who are covered persons under the statue, it is possible to make an argument that, in establishing the Board and naming to it individuals who would so clearly have financial interests in the Board's actions, the City Charter may have intended that Section 1090 not apply to the Board. The authors of the Charter were fully cognizant that the Board would make decisions that would have an impact on the current and retired employees of the City. Given the "conclusive presumption" that any contract made by a board that has even a single member with a prohibited financial interest under 1090 is void, application of 1090 means that the City Charter would have essentially established a board that could not function in achieving its main purpose. That clearly could not have been their intent.[5] (This may not be controlling, however, as the Legislature apparently didn't intend for local agencies to have the option of exempting officials from Section 1090's reach.)

A stronger argument is that the application of Section 1090 to the

[5] Although there is a "rule of necessity" that allows boards to act when one of their members has a conflict, that rule also requires that the members with the conflicts not participate in the action. (69 Ops.Ca.Atty.Gen 102.) However, when this rule is applied to the Board, the three City officers, the three employees and the retired employee would all be disqualified, leaving many of the important decisions of the Board up to the four public members. That would hardly have been the intent of the drafters of the Charter provision establishing the System.

operations of the Board creates a potential conflict with the provisions of the Charter (which intended that the specified individuals make the required decisions of the System). In that case, we would need to apply the principles that have been developed to address conflicts between state laws and local provisions that address "municipal affairs."

As a charter city, the City may "make and enforce all ordinances and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided" in its charter. (Cal. Const. Art. XI, Section 5.) City charters adopted under the Constitution "with regard to municipal affairs shall supersede all laws that are inconsistent therewith." Otherwise, the City is subject to the general laws of the state. It has been conclusively held that the establishment of pensions and pension systems is a "municipal affair." (Murphy v. City of Piedmont (1936) 17 Cal.App.2d; City of Downey v. Board of Administration, Public Employee Retirement System (1975) 47 Cal.App.3d 621.) However, Section 1090 regulates the operation of the System, not the City's power to create it. In order to address the potential conflict between Section 1090 and the Charter's provisions establishing the System, a court would look to the case law that has interpreted Article XI, Chapter 5. An analysis of the two seminal cases addressing conflicts between charter city legislation and state law provides some very useful guidance in navigating this often-confusing area.

In two cases, California Federal Savings and Loan Assn. v. City of Los Angeles (1991) 54 Cal.3d 1 ("Cal. Fed.") and Johnson v. Bradley (1992) 4 Cal.4th 389 ("Johnson")[6], the California Supreme Court reexamined and restated the process for analyzing conflicts between charter city laws addressing municipal affairs and general state statutes. As these cases show, the task is not an easy one. The threshold inquiry is deciding whether there is an actual conflict between the two laws. As the court in Cal. Fed. stated: "To the extent difficult choices between competing claims of municipal and state governments can be forestalled in this sensitive area of constitutional law, they ought to be; courts can avoid making such unnecessary choices by carefully insuring that the purported conflict is in fact a genuine one, unresolvable short of choosing between one enactment and the other." (54 Cal.3d at 16-7.) The Cal. Fed. court notes two cases (Bishop v. San Jose (1969) 1 Cal.3d 56 and Weekes v. City of Oakland (1978) 21 Cal.3d 386) in which it found "no real conflict."

As the Cal. Fed. decision notes, if a genuine conflict is found between a local law addressing a municipal affair and a state statute, a court must then determine whether the state law addresses a statewide concern. Otherwise, the municipal law is beyond the reach of state legislative control. If however, the state statute addresses a matter of statewide concern and is reasonably related to its resolution, then the state law controls. Essentially, the analysis then boils down to whether, "under the historical circumstances presented, the state has a more

[6] Cal. Fed. struck down the imposition of a municipal business license that conflicted with a statewide scheme to limit local taxation of savings and loan associations, while Johnson upheld a local program for publicly financing campaigns in light of a claim that it was invalidated by a state initiative that prohibited such programs.

substantial interest than the charter city." (Cal. Fed., 54 Cal.3d at 18.) Thus, in cases presenting a true conflict, "the hinge of the decision is the identification of a convincing basis for legislative action originating in extramunicipal concerns, one justifying legislative supersession based on sensible, pragmatic considerations." (*Id.*)

In our case, a court should be able to avoid finding an "actual conflict" between the Charter provision establishing the make-up of the Board and Section 1090, by finding that 1090 does not extend to agreements between different agencies of the City government. That way, the Court could permit the City to establish the Board with the make-up it feels to be optimal, without creating a conflict with state law.

However, if a court were not to accept that argument, it would be difficult to argue that 1090 did not address a matter of statewide concern. In our highly interdependent state, no tenable argument can be made that only the citizens of a particular city have an interest in the absence of public corruption. Clearly, businesses, property owners, other government agencies, as well as citizens of adjoining municipalities, all may be affected by a corrupt city government. In fact, as the court in Johnson noted: "[W]e agree with petitioners that charter cities may not enforce laws that are inconsistent with or impede statewide regulation of the integrity of the political or electoral process . . . ." (Johnson, 4 Cal. 3d 394, fn. 4.)

In this case, assuming the agreement between the City and the System is a "contract" within the meaning of Section 1090 and a court does not interpret Section 1090 such that a conflict is avoided, there is not much doubt that the members of the Board "participated" in making the contract when they voted to approve it. In fact, the law conclusively presumes that all members of a board that executes a contract, even those members who did not vote on the contract, are presumed to have participated in making it.

c. Financial Interest

The most difficult element of this analysis may involve the determination of the existence of a "financial interest." The statute does not define the term "financial interest," although it has been extensively explored in the case law and is generally defined very broadly. We will analyze it, and the specific circumstances of the agreement in question, below. In addition, the exemptions from Section 1090 mainly operate with regard to the financial interest element, defining certain interests to be either "remote interests" or "non-interests." We will look at the possible exemptions first.

(i) Interest in City Salary

With regard to the interest that six members of the Board may have with regard to the contract with the City, Section 1091(b)(13) holds that the interest of any employee of a governmental agency in his or her salary, per diem or reimbursement of expenses from a government agency is a remote interest. Therefore, the Board members who are City

employees would have a "remote" interest in an agreement between the System and the City due to their salaries. Thus the affected Board members could have disqualified themselves from the consideration of the contract with the City. An argument can be made that their interest was so obvious that no notice was required, but even if that was acceptable, it does not cure the fact that they may have actually participated in approving the contract (or simply been a member of a body or board that made a contract with an entity (the City) in which they had a financial interest (their salary)).

(ii) Interest in System Benefits

Another exemption that may be applicable here is listed in Section 1091.5(a)(3). It states that a public official shall not be deemed to have a financial interest in a contract when his or her interest is "that of a recipient of public services generally provided by the public body or board of which he or she is a member, on the same terms and conditions as if he or she were not a member of the board." The challenge here is showing that the payment of retirement benefits falls within the definition of a "public service." There is no case law interpreting this provision. I believe we are left with a straight statutory interpretation. It is clear that the System is really only intended to provide one thing—employee benefits. To the extent that public agencies are created to serve the public (in this case to provide benefits to public employees, which arguably insures their loyal service throughout their careers), that is the function the Board serves.

The preceding exemption is, in many ways, a restatement of an exception also used in the regulations implementing the Political Reform Act (PRA). This exception is based on the concept that actions that affect the "public generally" should not be the basis for a conflict of interest (presumably on the grounds that such a prohibition would prevent any action at all, as every citizen would be barred from action.) A specific regulation of the Fair Political Practices Commission, which implements the PRA, applies to members of board and commissions "who are appointed to represent a specific economic interest" and exempts them if the statute or ordinance creating the position requires them to represent that position, if the decision does not involve any other personal interests and the decision will "financially affect the member's economic interest in a manner that is substantially the same or proportionately the same as the decision will affect a significant segment of the persons the member was appointed to represent." (Title 2, Cal. Code of Regs. § 18707.4). This concept would clearly apply to the three members of the System as well as the retired member. It is more difficult to extend it to include the City Manager, Auditor and Comptroller and City Treasurer, as it is not clear that they were appointed to the Board to represent their personal interests in their retirement benefits. (However, it can also be argued that they were appointed to represent both their personal interest as recipients and the specific functions they serve with the City.)

(iii) Effect of Contract on Interests

As to the financial interest of the members, there may be some question whether the members of the Board actually had a financial effect in the agreement. As stated earlier, Section 1090 does not define what a "financial interest" is. However, the case law has examined the issue quite thoroughly and, applying the concept that the statute is to be "strictly construed," has found many types of situations to feature prohibited interests. The most telling comment on this process states "however devious and winding the chain may be which connects the officer with the forbidden contract, if it can be followed and the connection made, the contract is void." (People v. Deysher (1934) 2 Cal.2d 141.) It is essential that we analyze the exact effect of this particular contract will have upon the members of the System (and hence the members of the Board). If there is any chance at all that the City-System agreement will increase benefits (or even insure that the benefits promised in the City-Union agreement are paid), the City-System agreement would likely result in a financial interest on the part of the members of the Board that are also members of the System. It has been noted that by the time the contract was concluded, the City was fully obligated to provide the stated benefits and the contract merely provides a method to implement them. This may require further inquiry in order to be able to show that no financial effects resulted from the contract.

2. Special Conflict Rules

There is also precedent for the application of special rules to a conflict analysis. In several instances, courts have held that specific conflict provisions that differ from Section 1090 should be enforced in its place. (See Old Town Dev. Corp. v. Urban Renewal Agency (1967) 249 Cal.App.2d 313 and 51 Ops.Cal.Atty.Gen. 30.) However, in such instances there is a specific conflict provision that takes precedence over the more general provision of Section 1090. There is no such special statute present here, although perhaps an intent to have such an exception is inherent in the structure of the Board.

B. Effect of Conflict Upon Contract

If any member of the Board that acted on the agreement had a conflict under Section 1090, the law holds that the agreement would be void. Although the language of Section 1092 states that a contract made in violation of Section 1090 may be voided, case law has consistently held that such contracts are void, not voidable. (*See* Thompson v. Call (1985) 38 Cal.3d 633.) In addition, any entitlement to payment pursuant to a contract made in violation of Section 1090 is also void and the payment of any compensation is disallowed.

cc: CMH, MKT